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## REFUNDING THE FOREIGN DEBT OF HONDURAS

Were it not for the banana industry, Honduras would be practically unknown to the outside world, yet it is only three and a half days from New Orleans and is actually closer to Chicago than is San Francisco. When its mineral, timber, agricultural, and pastoral industries are developed, however, Honduras will be of considerable trade importance to us. Its position in relation to the other republics of Central America is that of the central, or buffer state. Make Honduras a zone of quiet, peace, and industry, and the revolutionary "game" will soon disappear from Central America. To this end the refunding of the foreign debt is the most practical plan that has been put forth.

The history of the foreign debt of Honduras is an amazing example of international high financiering. The audaciousness of the frauds perpetrated, both upon the investors and upon the government of Honduras, by the unscrupulous promoters who engineered these loans in London and Paris, is almost unparalleled. It resulted in saddling a foreign debt which now amounts to more than \$112,000,000 upon a little country with an annual revenue of less than \$2,000,000, and with barely 600,000 inhabitants, most of whom are non-productive Indians. At the time the debt was created, the yearly revenue of Honduras amounted to barely \$300,000, while the loans called for an annual interest charge of nearly \$3,500,000. This huge debt has hung like a pall over the unhappy and distracted republic. Time and time again, the bondholders have checked attempts on the part of American capitalists to build roads or to develop the resources of Honduras, claiming that its government had no right to dispose of any of its assets without the settlement of these claims.

In the following pages the attempt will be made to show how these claims arose, what Honduras actually received, and what is the basis for the settlement that is now being effected.

In 1825, the Federal States of Central America negotiated

a loan in London of £163,000 at 6 per cent interest. On the dissolution of the federation in 1827 this debt was distributed among the five republics, the amount falling to Honduras being £27,200.

Between 1825 and 1861, Honduras became indebted to the British government, under the Mesquite Territory Convention, and to various British subjects, to the extent of £31,545. Deducting a small amount paid upon the principal of these debts, there was left in the year 1867 a total obligation upon the country, upon which no interest had ever been paid, of £120,451.

In 1853 the government of Honduras entered into a contract with Mr. George L. Squier, who represented an American company, for the construction of a railroad to be known as the Inter-oceanic, and to extend from Puerto Cortes, on the Atlantic coast, to the Bay of Fonseca, on the Pacific. Owing, it is said, to the opposition of those engaged in the construction of a line across Panama nothing was done with this proposed work. In 1857-58, Lord Clarendon organized a British company which made a careful study and survey of the proposed route, at a cost of approximately £50,000. The enterprise went no farther at that time on account of the wars that soon followed in Italy, the United States, and Mexico. In 1866 the matter was again taken up, and the president of Honduras gave his ministers in London and Paris full power to treat and to contract for the construction of the proposed road. They were to guarantee the payments upon any issue of bonds which the government might authorize by pledging the general revenues of the republic, the income of the railroad, and the unoccupied lands of the state.

Before a bond issue could be floated, it was necessary to take up the old federal debt, which now amounted, with accumulated interest, to £90,075. So it was arranged that the republic should issue in London £90,000 of 5 per cent bonds, pledging for security the receipts of the Amapala customs house. Of this amount £55,000 were to be delivered to the holders of the federal debt, in exchange for their £27,000 of 6 per

cent bonds and their £62,875 of arrears of interest. Of the £35,000 remaining, £15,000 were given to Messrs. Hart & Co. as security for their claim of £7,300, and £20,000 were issued for expenses and brokerage.

Of this original issue of £90,000, bonds to the value of £11,150 were redeemed with money taken from the proceeds of subsequent loans, £15,000 were redeemed by a payment to Hart & Co. of £6,000 obtained from the same source, and £2,900 were retained in the hands of the government commissioners, so that the outstanding balance proper was £60,950. There was English diplomacy back of this first loan to build the road, as there was also back of the Tehuantepec and other Isthmian roads.

Such was the financial situation of Honduras when Messrs. Bischoffsheim & Goldschmidt, of London, contracted with Señores Gutierrez and Herran, ministers of Honduras in London and Paris, respectively, to issue a loan, on commission, for £1,000,000, with 10 per cent interest and 3 per cent sinking fund. The issue price was to be 60 and the gross amount to be realized would, therefore, be £600,000. The avowed object of this loan was the construction of the first section of the Inter-oceanic Railroad across Honduras. The length of the line was to be about 230 miles, and the cost, as estimated by the British engineers, about £2,230,000. It was claimed that this line would save 1,103 miles on the distance between New York and San Francisco, as compared with the Panama route. It was also claimed that the construction of the road would open up for development a vast tract of country abounding in forest and mineral products sufficient to pay for completing the road after the opening of the first section. A small part of the loan was to be used for the development of the mines and forests.

The government of Honduras was anxious to see this project carried out but there were no funds available, from the ordinary revenues, to apply to such a loan, and it seemed that the railroad had to be looked to as an immediate success capable of yielding a large revenue. In spite of this situation, the government, upon the issue of the loan of 1867 upon the terms just

recited, undertook to pay the huge sum of £140,000 annual interest and amortization for fifteen years from December 31, 1869, at the end of which time it was to own the road outright and be entirely free from liability. The subscribers to this loan were further promised one-half of the profits of the line for fifteen years after the complete repayment of the loan.

It is said that the only application for this loan was for £10,000 sent in by the issuing house itself, but that by sending out false statements as to the amounts subscribed for, the public was induced, by June 30, 1868, to take as much as £49,500. In order to dispose of the balance, the bonds were quoted at a fixed price to a Mr. LeFevre, who proceeded to "make a market." In this way the total issue of the £1,000,000 loan of 1867 was disposed of as follows:

To the public through the prospectus.....	£ 49,500
Placed by Mr. LeFevre .....	631,200
To the railroad contractors .....	200,000
To Bischoffsheim & Goldschmidt for commissions and expenses .....	108,500
Drawn before issued and cancelled .....	10,800
	<hr/>
	£1,000,000

The proceeds of this loan were to be distributed as follows:

For the first section of the road.....	£500,000
For the development of the mines and forests, for the engineers, etc. ....	100,000
For three commissioners, etc. ....	4,000
For commission of 1½ per cent for brokerage, etc. ....	12,000
For interest for two years .....	114,000
Commission to the syndicate for payment of coupons and amortization .....	20,000
Commission of 5 per cent to the syndicate for payment out of first money realized .....	50,000
	<hr/>
	£800,000

The net amount actually received from this issue was £620,035, and its disposition, neglecting a few items, was as follows:

To the government of Honduras .....	£ 51,617
To the railroad contractors (in addition to bonds mentioned above) .....	293,080
To interest and sinking fund for the two loans of 1867.....	108,742
To buying back scrip .....	114,330
To salaries of engineers and trustees.....	27,876
To the issuing house as commission (in addition to the £108,500 bonds) .....	16,900
	<hr/>
	£612,545

The management of the funds destined to the construction of the road was placed in the hands of three commissioners, one of whom was to be the representative of the government of Honduras in London and the other two were to be chosen by this one from a list presented by the syndicate. It was stipulated that one of the two should always be a member of the house of Bischoffsheim & Goldschmidt. In case of default of interest on the part of Honduras, the syndicate was to take possession of the road. Another important provision was to the effect that if three-fourths of the loan should not have been subscribed before January 1, 1869, the contract was to be null and void. At that date it would seem that only about £100,000 had been taken, and by 1870 not even two-thirds of the loan had been placed. This failure to comply with the agreement became the basis later of Honduras' claim for exemption from liability on the bonds.

In another agreement, signed October 25 of the same year (1869), it was arranged, in order to facilitate the loan of £1,000,000, that a second annuity of £100,000, payable during fifteen years, counting from the opening of the line, should be authorized by Honduras in addition to that of £140,000. The issuing house was given the right to distribute this £100,000 to persons who might aid them in securing the sale of the bonds without having to give any account of the distribution or any list of names.

Hard as these terms were, the government of Honduras "approved in all its parts the first contract and the two additional conventions relative to the construction of the said road."

In 1869 a loan of £2,490,108 at  $6\frac{2}{3}$  per cent was authorized. It was put out in Paris for the ostensible purpose of "the completion of the Interoceanic Railroad now under construction." The security offered was practically the same as that which had already been pledged for the loan of 1867, namely, the railroad and its revenues and the general revenues of the state. The government of Honduras undertook to provide as interest and sinking fund for this loan the sum of £310,128 a year, and in addition to give the subscriber a participation, for fifteen years, in one-third of the revenue derived from the road. The actual rate of interest on this loan was over 17 per cent as against 19 per cent on the loan of 1867. If this nominal issue of £2,490,108 had been entirely taken up by the public at the issue price, it would have produced £1,867,581. But the response to the loan offer was very slight and the net result was that the issuing house (Dreyfus & Co.) actually owed the government for the part it had subscribed for. Of the proceeds of the loan only about £61,731 ever reached the contractor for the construction of the road.

Another loan of £2,500,000, at 10 per cent interest was authorized, and issued at 80. Its avowed object was "to conclude the Interoceanic Railroad and to place the line from sea to sea in working order." It likewise was guaranteed by the road and its income and by the products of the property of the state. It was stipulated that if a given amount of the loan should not have been subscribed for prior to August, 1870, the obligation on the part of Honduras should cease.

In order to prepare the market for this loan, some drawings of bonds to be paid off at par were announced. It was also announced through the papers that four cargoes of mahogany had arrived in London for use in payment of the debt. It seems that this mahogany had been bought by the government of Honduras from a private party, including members of the government itself, out of funds taken from previous loans. It is charged that the firm of Bischoffsheim & Goldschmidt received the cargoes thus sent over, kept the best for themselves, and sold only what was left, for application to the debt.

This issue of 1870 was traded in extensively by the issuing house itself, which succeeded by June 30, 1872, in getting the public to take £2,446,400. As a result of these operations, two-fifths of the loan of 1869 and the whole of that of 1870 produced £2,051,511 net, of which amount only £145,254 was applied to the construction of the road.

Regarding the methods used in placing these bonds, the Parliamentary Select Committee of 1875 said:

By means of exaggerated statements made in the prospectus, they [the promoters] induced the public to believe that the material riches of the contracting state constituted a sufficient guarantee for the payment of the loan. Even if such had been the case, the various governments have not taken any steps to apply the income of the republic, especially pledged, to the payment of its debt. In order to induce the public to invest with a guarantee absolutely inadequate, recourse was had to means which, by their nature and object, were flagrantly fraudulent. Your committee is of the opinion that these operations merit much censure.<sup>1</sup>

The committee further states that it agrees, for the most part, with the opinion of the Secretary of the Legation of Honduras, that "the fact of the unfortunate transaction falls upon all those who have interests, rights, reclamations, complaints, or any participation, whatever it may be, in these transactions. It is a kind of original sin which extends to even the most innocent who have anything to do with this loan." And the committee concludes its report by saying: "The remedy for such proceedings must be found in the tribunals of the country."

The failure of these three loans and a knowledge of the actual condition of the country did not prevent an attempt to float still further loans. To this end Don Carlos Gutierrez, the minister of Honduras in London, issued a prospectus in May, 1872, upon his own authority, inviting subscriptions to a loan of £15,000,000 for the purpose of constructing a ship railway across the country. The public did not respond and the invitation was withdrawn after a few days, the government of Honduras afterward disavowing Señor Gutierrez' acts. In Decem-

<sup>1</sup> *Parliamentary Blue Book Select Committee Report* (1875).



ber, 1872, Captain Prim, who had been appointed a special commissioner by Minister Gutierrez to promote the railroad, went to Paris to endeavor to raise a loan of £2,000,000 at 10 per cent interest, issued at 70. Nothing ever came of this attempt. It may be noted that Señor Gutierrez never returned to his country.

It seems that the government of Honduras gave to the issuing house the possession of the money arising out of the loans, most generous commissions, and the administration of the mines and forests of the state, but received nothing in the way of a guaranty for the construction of the road.<sup>2</sup> The proceeds which arose from the sale of the bonds were enough to have built the road, but less than one-fourth of it was ever actually constructed.

According to an estimate made by the Select Committee in 1875, the following were the amounts held by the public of these various loans, after deducting those drawn and redeemed.

Federal loan of 1867, interest 5 per cent.....	£ 61,000
Loan of 1867, interest 10 per cent .....	680,000
French loan of 1869, interest 6½ per cent.....	600,000
Loan of 1870, interest 10 per cent.....	2,446,400
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	£3,787,400
In hands of government agents and contractors.....	2,263,708
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Total .....	£6,051,108

Señor Fontecha, the Spanish consul in Tegucigalpa for many years, made a careful study of the foreign debt of Honduras and came to the conclusion that the following amounts were realized in connection with the loans:

Total capital received for bonds issued.....	£ 5,380,670
Interest on capital to August 1, 1908.....	16,393,078.18
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Grand total .....	£21,773,748.18
Grand total in dollars .....	\$108,868,740.41

<sup>2</sup>J. Maria Moncala, *Deuda del Ferrocarril de Honduras* (1904).

Of the amount realized on the sale of the bonds, Señor Fontecha estimates that Honduras has received:<sup>3</sup>

By cancellation of bonds of federal debt .....	£ 3,600
By payment of interest on the same .....	24,300
By cancellation of debt of Hart & Co. ....	6,000
By expenses in connection with the mines.....	4,391. 6. 0
By drafts of government paid in London .....	79,321. 6. 0
By payments for the mines .....	16,505.13.10
By "various" sums .....	7,558. 0.10
By nickel money received .....	120,000. 0. 0
By freight and insurance on the same.....	1,493. 0. 0
By drafts on Paris .....	2,800. 0. 0
By advances to the government .....	57,318. 5.10
By "various" payments .....	12,304. 7. 9
By payments to the contractors of the railroad out of the loan of 1867 .....	446,048. 0. 0
By payments out of the loans of 1867 and 1870....	26,465. 0. 0
By payments out of the loans of 1867 and 1870 again	217,232. 0. 0
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Amount received .....	£1,025,537. 0. 0
Deduct for woods, etc., sold in London .....	6,092.16. 2
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Total amount received .....	£1,019,444. 3.10
By interest and premiums of emission.....	1,320,407.16. 0
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Grand total .....	£2,339,851.19.10
Grand total in dollars .....	\$11,699,259.95

Honduras has never attempted, since it became an independent state in 1827, to meet the interest on its debt. What was paid in the form of interest during 1867-69, and 1870-71 was actually paid out of the bondholders' own money. Therefore, when interest was suspended on January 1, 1873, the situation was not altered in any way.

Honduras claims the invalidity of the debt on the following grounds:

1. Because on January 1, 1869, there had not been realized the three-fourths part of the first loan;
2. Because the sums which the Dreyfus firm was to raise were not raised within the stipulated time;

<sup>3</sup> Fontecha, *El Deuda Exterior de Honduras* (1909).

3. Because the third loan was not raised by August 1, 1870, in accordance with the agreement;

4. And because the road was not actually constructed.

Honduras does not seem to have questioned the moral obligation resting upon her to pay for what she received. To this end, Señor Ugarte, who was sent to London in 1904 for the purpose of negotiating for the reorganization of the debt, made the following propositions to the Bondholders' Committee:<sup>4</sup>

1. Honduras actually received fifty-three miles of easily constructed railroad which may be estimated at £212,000; about £100,000 for the payment of the federal debt; a quantity of arms and ammunition, and of nickel coin, making a total of £312,000.

2. The maximum value of the bonds at their actual quotation is 6 per cent on their original value, thus making the present actual debt equal to £323,920.4.

3. The annual income budget of Honduras amounts to only about £200,000 and if more than 10 per cent of this amount is abstracted for application to the debt, the administration of the country will be rendered impossible.

4. To recognize the bonds at their maximum present price, that is, at 6 per cent, and pay them with a yearly interest of 4 per cent and a sinking fund of 2 per cent, making in all £549,944, payable in twenty-eight years and three months.

The sub-committee of the bondholders declared the proposal put forward by Señor Ugarte to be inadmissible.<sup>5</sup>

Sir Lionel Carden, the British minister to Central America, subsequently made the following proposal on behalf of the bondholders:

1. An annual payment of £40,000 for 40 years;

<sup>4</sup> Angel Ugarte, *Documents Referring to the External Debt of Honduras* (1904).

<sup>5</sup> The Council of the Corporation of Foreign Bondholders was formed in 1863. It was authorized by a special license of the Board of Trade in 1873 and was incorporated by an act of Parliament in 1898. The principal object of the association is to protect the interests of the holders of foreign securities and to give information regarding the economic situation of the countries whose bonds are held. If the individual bondholders think their holdings are prejudiced by any foreign government, they can petition the council for appropriate measures.

2. The government of Honduras to pledge the revenue of the railroad and the wharf at Puerto Cortes for 40 years, or as long as might be needed to extinguish the debt, and to turn these properties over to the administration of the bondholders;

3. The government to emit bonds to the amount of £100,000, hypothecating the road, and the proceeds to be used for the rehabilitation of the road;

4. The government also to place an additional duty of 15 per cent on imports, to be used in the payment of the annual £40,000.<sup>6</sup>

A short time after this the late Mr. Buchanan, representing Morgan & Co., undertook to bring order out of chaos. One of his proposals was to fund the outstanding bonds, which were quoted at three to five cents on the dollar, on a 6 per cent basis, into a new loan of \$2,750,000, payable in twenty-eight years at 4 per cent. As an alternative proposition, Mr. Buchanan suggested that the government of Honduras should purchase in instalments through the Bondholders' Association all of the bonds then on the market, beginning at 5 per cent (the highest quotation at that time) and increasing the price every year until the maximum of 12 per cent should be reached, and thus redeem the entire amount in twenty-two years or less, for a total sum of \$3,000,000. The third proposition was that the government of Honduras should grant 200,000 acres of land in small tracts, to be selected by the bondholders in any part of the republic, in exchange for the cancellation of the debt.

The Bondholders' Association rejected all these propositions. Señor Ugarte, the commissioner of Honduras, then appealed to the British government, but the Earl of Lansdowne, who was at the head of the foreign office, declined to take up the matter. At this stage pressure was brought to bear upon Washington to take a hand in the affair rather than let any European country intervene for the purpose of collecting the debt by force. The United States did not wish to assume any of Honduras' obligations, and yet did not care to stand by while

<sup>6</sup> *Thirty-fifth Annual Report of the Council of Foreign Bondholders* (1908).

European nations threatened a forcible collection of the debt. So it became necessary to formulate a plan agreeable to both parties. Accordingly, the United States government suggested to the government of Honduras the desirability of effecting a speedy and amicable adjustment of its foreign debt and invited it to send commissioners to negotiate with the firm of Morgan & Co., which represented the foreign creditors. Honduras appointed two commissioners, who reached New York in September, 1909. They reported favorably to their government and President Dávila recommended speedy action to his Congress, which met in January, 1910. His political opponents aroused the people by telling them that this was simply a means of selling the country to the "Gringos" (foreigners) and the proposition was not accepted. It has now been accepted, however, if reports are correct, after a prolonged struggle between President Dávila and his Congress, and the foreign debt will soon be adjusted. The terms of the settlement have not been disclosed at this writing, but it is understood that the old bonds will be retired at 15 per cent of their face value in favor of a new issue of 4's maturing in about thirty years. While this is a pretty stiff sum to pay, considering both the amount which Honduras actually received and also the price prevailing when Morgan & Co. entered into the negotiation, yet even a hard bargain may be better than none at all. It has been reported that the loan will amount to about \$10,000,000 in all, \$4,000,000 of which will be used in retiring the old bonds and the balance in constructing the long-contemplated Inter-oceanic Railroad from Puerto Cortes to the Bay of Fonseca, on the Pacific. With some little money for rehabilitation, with some supervision of the customs in the interest of the new bondholders, thus putting a quietus on revolutions, the cloud which the old debt cast over the country will be raised and Honduras should make considerable progress during the coming years.

In the proposals made for the settlement of the debt it has frequently been suggested that the revenue of one or all of the customs houses be hypothecated. It may be worth while to point out, therefore, what this income would amount to. For

the fiscal year 1898-99, the total receipts from this source amounted, in silver, to \$1,819,659.28; or about \$727,863.71 gold; for 1907-8, to \$1,682,070.03, or \$672,828.01 gold.

For the decade 1898-1908, the total net revenue, in silver, was \$29,633,146.09  $1/4$ , equivalent to \$11,853,258.43 gold, or \$2,963,314.60  $4/5$ , silver, equivalent to \$1,185,325.84, gold, annually. The excess of expenditures over receipts in the decade was, in silver, \$2,427,357.14, equal to \$970,942.85, gold, or \$242,735.71, equal to \$97,094.28, gold, annually. For the year 1908-9 the total net revenue was \$3,818,446.30 in silver, equivalent to \$1,527,378.52 in gold; the total expenditures were \$4,084,984.04 in silver, equivalent to \$1,633,993.61 in gold.

The estimate of receipts for the year 1909-10 was, in silver, \$1,800,000, or \$720,000 gold, from duties on imports; \$142,500, or \$57,000 gold, from duties on exports; \$1,750,000, or \$700,000 gold, from taxes on liquors and tobacco; and \$1,091,500, or \$436,600 gold, from miscellaneous sources; in all \$4,714,064.92, equivalent, roughly, to \$1,885,625.96 gold. From these figures it will readily be perceived that if a \$10,000,000 loan on a 4 per cent basis is placed, between one-fourth and one-fifth of the total income will be required to meet the annual interest charge.

SAMUEL MACCLINTOCK

CHICAGO